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Impact of Chinese Mercantilism State on India

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Abstract

Mercantilism is a set of economic ideas about how a country can get rich. Several European countries embraced this theory between the 16th and 18th centuries. While there are several different versions enacted, there are four basic economic principles or rules of mercantilism.

1. *A country becomes rich and powerful by collecting as much gold and silver as possible.*
2. *A country becomes rich and powerful by increasing the number of colonies it has.*
3. *The mother country should produce manufactured goods, while the colonies should provide natural resources.*
4. *A country should have more exports than imports.*

Now it is being felt that China is adopting mercantilism attitude. Indiahas to reconcile the imbalance of trade with China by adopting some solid measures. There is a hope with PM Mr.NarenderaModi in this direction.

Key words:*Mercantilism, export, import, balance of trade, FDI, Chinese market.*

Prologue

Mercantilism is an economic system that dominated the major European trading nations during the sixteenth, seventeenth, and eighteenth centuries. This "mercantile system" was based on the premise that national wealth and power were best served by increasing exports and collecting precious metals in return.

The following ideas, and the underlying principles, may be called mercantilism:

1. The economic health or wealth of a nation can be measured by the amount of precious metal, gold or silver which it possessed.
2. A favorable balance of trade is essential.
3. Each nation should strive for economic self-sufficiency, increasing domestic production, and founding new home industries.
4. Agriculture should be encouraged, reducing the need to import food.
5. Tariffs should be high on imported manufactured goods and low on imported raw material.

6. A merchant fleet is of vital importance, avoiding the need for foreign assistance in transporting goods and raw materials.
7. Colonies should provide markets for manufactured goods and sources of raw material.
8. A large population is important to provide a domestic labor force and to people colonies.

The crown or state should be heavily involved in regulating the economy (Rempel 1998).

Definition

Mercantilism was a political movement and an economic theory, which was found particularly in Europe between 1600 and 1800. The term "mercantilism" was not in fact coined until 1763, by Victor de Riqueti, marquis de Mirabeau, and was popularized by Adam Smith in 1776. In fact, Adam Smith was the first person who organized formally most of the contributions of mercantilists in his book *The Wealth of Nations* (Niehaus 1990: 6).

No general definition of mercantilism is entirely satisfactory, since it was not as mucha school of thought as a collection of policies intended to keep the state prosperous by economic regulation (Rempel 1998). Philipp von Hörnigk (1640-1712) laid out one of the clearest statements of mercantile policy in his 1684 . There, he listed nine principle rules:

To inspect the country's soil with the greatest care, and not to leave the agricultural possibilities of a single corner or clod of earth unconsidered… All commodities found in a country, which cannot be used in their natural state, should be worked up within the country… Attention should be given to the population, that it may be as large as the country can support… gold and silver once in the country are under no circumstances to be taken out for any purpose… The inhabitants should make every effort to get along with their domestic products… [Foreign commodities] should be obtained not for gold or silver, but in exchange for other domestic wares… and should be imported in unfinished form, and worked up within the country… Opportunities should be sought night and day for selling the country's superfluous goods to these foreigners in manufactured form… No importation should be allowed under any circumstances of which there is a sufficient supply of suitable quality at home (Ekelund and Hébert 1996).

Historical Background of Mercantilism

Adam Smith coined the term “mercantile system” to describe the system of political economy that sought to enrich the country by restraining imports and encouraging exports.
Adam Smith saw it as serving only the merchant class and argued that real wealth was to be equated with full employment through greater production of goods and services. In more recent times, the mercantilism dogma was revived by the UK economist John Maynard Keynes (1883-1946) when he stated that a surplus in balance-of-trade stimulates demand, thus increasing the national wealth. When corporations, politicians, and unions demand control over imports through higher-duties to protect local jobs andindustries, they are resorting to mercantilism.

This system dominated Western European economic thought and policies from the sixteenth to the late eighteenth centuries. The goal of these policies was, supposedly, to achieve a “favorable” balance of trade that would bring gold and silver into the country and also to maintain domestic employment. In contrast to the agricultural system of the physiocrats or the laissez-faire of the nineteenth and early twentieth centuries, the mercantile system served the interests of merchants and producers such as the British East India Company, whose activities were protected or encouraged by the state.

The most important economic rationale for mercantilism in the sixteenth century was the consolidation of the regional power centers of the feudal era by large, competitive nation-states. Other contributing factors were the establishment of colonies outside Europe; the growth of European commerce and industry relative to agriculture; the increase in the volume and breadth of trade; and the increase in the use of metallic monetary systems, particularly gold and silver, relative to barter transactions.

Objectives of the Study

The objective of the research paper is to reveal what are the causes of mercantilism? What are the effects and impacts of mercantilism on the balance of trade of India? Measures which are useful in tackling the problem of balance of trade?

Methodology Applied:

The research methods used for the completion of the paper were the content analysis and comparative analysis. These methods will include through investigation of the experience in this field through the suggested materials and through the materials from the internet.

Mercantilism and China

Bilateral Trade between India & China:

India & China signed a Trade Agreement in 1984 which provided for Most Favored Nation Treatment and later in 1994, the two countries signed an agreement to avoid double taxation. The bilateral trade crossed US$13.6 billion in 2004 from US$ 4.8 billion in 2002, reaching $18.7 billion in 2005. The India China trade relations have been further developed from 2006, with the initiation of the border trade between Tibet, an autonomous region of China, and India through Nathu La Pass, reopened after more than 40 years. The leaders of both the countries have decided to enhance the bilateral trade.

Indian Exports to China under the India China Trade Relations

India exports to China particularly ores, slag and ash, iron and steel, plastics, organic chemicals, and cotton. In order to increase the extent of exporting Indian goods to China, however, there should be a special emphasis on investments and trade in services and knowledge-based sectors. The other potential items of trade between India and China are marine products, oil seeds, salt, inorganic chemicals, plastic, rubber, optical and medical equipment, and dairy products. Great potential also exists in areas like biotechnology, IT and ITES, health, education, tourism, and financial sector.

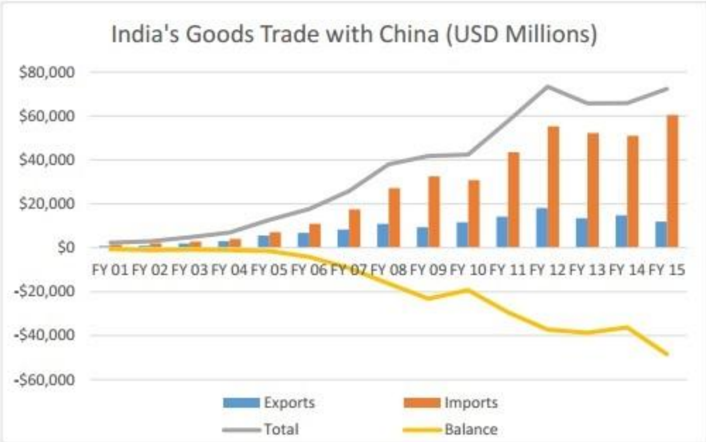
Chinese Exports to India under the India China Trade Relations

The main items which that China exports to India are electrical machinery and equipment, cement, organic chemicals, nuclear reactors, boilers, machinery, silk, mineral fuels, and oils. Value added items like electrical machinery dominates Chinese exports to India. This exhibits that Chinese exports to India are fairly diversified and includes resource-based products, manufactured items, and low and medium technology products. It is said that if India is to capture the markets of China and enjoy profits, then it would have to discover new merchandise and branch out its exports to China**.**

Deficit in Balance of Trade: Ministry of Commerce and Industry of India released its country-by-country trade data for fiscal year 2015. As per this report, the nation’s trade deficit with China has spiked by 34 percent to $48.5 billion — nearly 3 percent of the nation’s GDP.

It was the quick rise of a big trade deficit with China that fueled India's adoption of mandatory local manufacturing rules in 2010. This new set of data means that the pressure to maintain such rules is not likely to abate any time soon — underscoring the need for the U.S. government to maintain its pursuit of positive economic cooperation in other areas.

Far too often, the fact that China has grown to be India's largest trading partner in goods is pointed to as proof of a burgeoning relationship. Total trade between India and China was $72 billion in FY 2015, about $8 billion higher than with the United States, which is India's second-largest trade partner. Yet the size and growth of India-China trade masks a more disconcerting problem - China enjoys a 4-to-1 surplus in its goods trade with India.



This trade imbalance has triggered several policy measures from New Delhi, particularly compulsory local manufacturing rules, which have riled U.S. companies and triggered a variety of reactions in Washington, D.C.

Ahead of India's release of its country-specific trade data, there were clear signs of a further weakening of the nation's trade balance with China. In mid-April, the Commerce Ministry released a big-picture review of the nation's balance-of-trade for FY 2015. The ministry revealed that, despite a 16 percent drop in India's oil import bill, the nation's net trade deficit increased by nearly 1 percent. India's overall trade deficit came in at $137 billion in FY 2015. This is well below India's peak trade deficit of $190 billion from FY 2013.

Maintaining a high trade deficit has not caused a dramatic outflow of the nation's foreign currency reserves. India's current account deficit is relatively stable at 1 percent of GDP, buoyed by remittances and India's dynamic services trade. And India's capital account remains healthy, as foreign investment has started to pick up again. However, economic policymakers often look at a country's industrial capacity as foundational to economic stability. Stimulating the rapid escalation of local manufacturing has been a cornerstone of the NarendraModi government in its first year, most notably through the "Make in India" campaign and accompanying reforms such as increases in foreign direct investment (FDI) caps, opening new sectors for private industry, and lengthening industrial licenses.

It is interesting to note that despite U.S. concerns over India's compulsory local manufacturing rules, we have seen a surge of U.S. exports to India in recent months. In the most recent 12-month period, U.S. exports to India have grown a bit faster (6.8 percent) than our imports from India (5.2 percent), as compared to the previous 12 months. This pace has accelerated in 2015, with U.S. exports to India growing 14.4 percent in January-April 2015 over the same period the year before. U.S. imports from India barely grew at all.

It is critical that the United States begin to achieve greater parity in its goods trade with India. However, the downside is that a resurgence in U.S. exports to India at a time when India's deficit with China is expanding could add further pressure in New Delhi to look for quick ways to offset these trade flows.

So the precarious trade triangle between the United States, India, and China will remain an important factor in U.S.-India relations. India's imbalance in goods trade may increase New Delhi's appetite to maintain or expand market access restrictions and may reduce interest in fully embracing agreement-based trade liberalization through the World Trade Organization or other pending trade agreements.

Reasons of Deficit of Balance of Trade:

There are many reasons that make China a mercantilist nations. Some of them are given below:

- To be a successful 20th century mercantilist state, China secured representation in world trade and financial institutions including the United Nations with the full support of developed nations. China gained international recognition and a major support base of compliant developing and developed nations.
- China is the modern world's most successful mercantilist state. Its policies have developed China into a global industrial, economic and military power and in so doing, reportedly accumulated the largest foreign exchange reserves in history.
- China claims its cheap goods drive the world's consumer economies, and while that may be, a mercantilist nation generates its trade surpluses and foreign exchange reserves at the expense of its trading partners' own exports, trade imbalances and employment opportunities.
- When operating in a co-operative global trade community, mercantilist policies are self-destructive, and can create division and friction between the state and its trading partners. Successful mercantilist economies require compliant trading partners, and their continuing annual increase in demand for its goods.
- China's poor track record in data reliability and lack of transparency to date raises a red flag for analysts assessing China's reports of rapid economic growth in the post GFC economy. As the effects of the global financial crisis and rising unemployment continue into 2010, plus China's destructive role in Copenhagen, the patience of the importing nations upon which China is reliant, is wearing thin.
- There is evidence from within China to indicate rapidly growing fault lines that are appearing through the smoke and mirrors of the state media image of China and its economy.

Tackling the deficit of trade between India and China:

The growing economies of China and India have provided the impetus to their respective governments to reorient their trade policies. The economic liberalisation of both countries and their subsequent policy reforms led to the development of infrastructure, competition, enhanced productivity and foreign investment, all of which boosted trade and investments in both countries. Comparisons between India and China, however, show that China's growth trajectory and volume of imports and exports has been much higher than India's. Compared to India's average growth rate of 13.5%, China's global exports saw a compounded annual growth rate of 17.2% between 1990 and 2012. As China's manufacturing sector developed, the volume of its exports compared to its imports rose accordingly.

Due to bilateral trade between India and China, the trade grew from US$2.2 billion in 2000 to US$72.2 billion in 2011, which made China India's largest trading partner. There was a decline in bilateral trade in 2012, however, to US$66.7 billion and a further drop to US$65.9 billion in 2013, although China's share of India's total imports continued to increase. The difference between the countries can be explained to a large degree by their exports. While India's exports to China are largely primary products like cotton and mineral ore, China exports technologically-intensive manufactured products to India.

India is highly dependent on Chinese electrical machinery, electronics and organic chemicals and the relative significance of each of these products has increased over time. India's imports of electrical machinery increased from 22 per cent in 2005 to 37 per cent in 2010, while its imports of electronics and organic chemicals increased from 14 per cent to 22 per cent and from 23 per cent to 30 per cent, respectively. It is essential; therefore, that India assesses and expands its exports to China. It also needs to ensure that the barriers that China imposes on its exports are removed or reduced as much as possible and also that investments from China are encouraged in India.Following measures should be adopted in order to reconcile the imbalance of trade with China :

(1.) India's Export should be potential in China

India maintained a good degree of export growth to China between 2004 and 2007, but the global recession adversely affected that trend, making India's export growth almost negligible since September 2008. The slow-down, however, was recently reversed. Despite having tremendous potential for its exports in Chinese markets, India has not made full use of that opportunity. India's exports to China could range from primary to technology-intensive products. According to a report from the Indian Institute of Foreign Trade (IIFT), there are 41 products including fish products, mineral fuels, pharmaceuticals and plastics, that China increasingly demands and which India can supply. India exports thirty of these products to destinations across the globe but not to China, an aberration that can easily be resolved.

Of the 25 products identified under Category I of the HS-6 commodities, there are only three that China imports from various sources worldwide. India, once again, exports these same products to various destinations worldwide but not to China.

China also imports only three Category II products from various sources, including India. While India's share constitutes over five per cent of those imports, the potential remains for it to increase its share. There are 19 products under category III that China imports, but the share of those products from India is less than five per cent, although New Delhi identifies the products as being export competitive. Essentially, India can further exploit Chinese demand for products in all three categories.

Apart from pursuing that avenue, India also needs to examine and explore China's pharmaceutical, services and parts and components sectors to find markets for its own manufactured goods and services. India has a competitive advantage and potential in both currently and potentially traded sectors, but it needs to identify and assess its competitiveness with the right policies to expand its exports to China which could, in turn, reduce the trade imbalance.

(2.) India should access the Chinese markets with more Products:

It is found that China's tariffs regime is lower than India's, and notably so for such products as mineral ores, plastics, man-made staple fibres and pharmaceuticals products. India is concerned, however, by non-tariff barriers and informal restrictions such as customs, standards and quantitative restrictions that make Chinese markets difficult to access. For example, India is very strong in three key sectors – pharmaceuticals, agriculture and IT services – but Chinese regulations impose restrictions that stifle the provision of Indian goods and services. India has, to use one example, signed several memoranda of understanding with China to export buffalo meat. This, however, requires lengthy sanitary and phyto-sanitary clearance and has to undergo certification procedures. As a result, the meat finds its way into China through Vietnam. In contrast, India imports 70 per cent of its active pharmaceutical ingredients from China. These barriers limit Indian exports and account for the trade imbalance to a large extent. According to the IIFT report, if India could capture ten per cent of the Chinese market, the spill-over effects in terms of specialisation and economies of scale would result in the faster growth and development of Indian exports to China, especially in pharmaceuticals and medical instruments.A closer dialogue is essential between officials and leaders of both countries. In this context, Mr Modi can play an important role to raise the issues of trade barriers and market accessibility with President Xi.

(3.) FDI from Chinashould be encouraged in India:

There is one more way to reconcile the trade imbalance with China i.e. to attract large amount of Foreign Direct Investment (FDI) from China. Although trade has grown dramatically between them, Chinese investment in India has been relatively low. The total cumulative FDI inflows from April 2000 to February 2014 amounted to US$321.81 billion. The metallurgical sector received 34 per cent of the total, followed by the automobile industry (25 per cent), industrial machinery (seven per cent), the services sector (six per cent) and power generation (four per cent). China has made significant promises in this regard since Mr Modi came to power in 2014. President Xi, during his last visit to New Delhi in 2014, announced that China would invest US$70 billion in building two industrial parks in Gujarat and Maharashtra and also outlined a five year plan to enhance trade and economic development and investment co-operation. China also promised its support to establish India's first railway university. India also seeks major investment from China to modernise its railways. As the two leaders have set an ambitious bilateral trade target of US$100 billion to be achieved by 2015, further talks in these areas are expected. Though most of these new investments from China have long gestation periods, they will boost India's infrastructure. India requires immediate investment in its manufacturing sector to improve output and employment opportunities and resolve supply-side issues if it is to address the trade deficit. In short, export-oriented FDI has the potential to turn India into a major industrial economy and will significantly aid it in addressing its trade deficit.

(4.) India's Structural Issues should be resolved on priority basis:

India has its own set of structural issues that need to be addressed to solve the trade deficit. Following its reforms in 1979, China encouraged exports to boost its economy, As a result, a large number of products being dumped in various markets like India. Since 1992, there have been 159 anti-dumping charges brought against China by India across broad sectors including steel, pharmaceuticals and consumer goods, in order to protect Indian manufacturers. This policy, however, has resulted in a further increase of the deficit. A cumbersome business environment and bottlenecks in infrastructure, labour laws and poor environmental standards have, furthermore, discouraged foreign investment and consequently affected the growth of the manufacturing sector in India. The security review process, complicated land acquisition procedures and administrative inefficiencies are other issues that Chinese investors face in trying to invest in India. Various Indian governments have not been able to make the best use of India's comparative advantages with China in order to tap into the under-exploited Chinese market. Fiscal issues and retarded growth, moreover, pose more problems for potential investors. India needs to solve these internal structural issues if it is to attract greater investment from abroad.

Epilogue

Mr PM NarendraModi will have a huge opportunity to discuss these issues with President Xi. Although border issues between the two countries have often dominated the relationship, one cannot overlook the trade deficit which, if not addressed, will increase to US$60 billion in the next two years, hampering Mr. PMModi's "Make in India" and "Smart City" initiatives.Since China has emerged as India's largest trading partner and increased India's dependence on its products, addressing the trade deficit is crucial to ensuring that the Sino-Indian relationship continues to prosper. While India has huge trade potential with China and can gain a lot from export diversification to China, but trade gape should be minimised in the favour of the country.On the priority basis, India has to expand its manufacturing sector and export.

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